THE CONTROL OF PRICES

AN OUTLINE OF PROSPERITY

BY

AUGUSTUS BAKER

PREFACE

THE title borne by this short book may perhaps be deemed unduly imposing. On the control of prices one or other of our foremost economists may at any moment produce a large and learned work. Indeed, we might almost say that several such works, though under different titles, have appeared already, for most economists nowadays attribute our economic disorders to uncontrolled fluctuations in the price level, and their remedies consist mainly of plans to smooth out these fluctuations by some sort of control.

Let me state at once that the control which they propose is quite different from that advocated here. Their control is a remote one, exercised through varying the quantity and circulation of money more intelligently than they are varied at present; the control that I consider necessary is direct, and exercised by lawful authority established for that purpose. The phrase that gives this book its title, then, is used in a simpler sense than that which it usually conveys in economic theory.

Now, though I regard their remedies as inadequate, I believe that our economists have provided in recent years all the data necessary for a complete solution of our major economic problems. If they have stopped short of completely stating the solution to which the results of their researches point, this may be due, for all we know, to the limited

view they take of what an economist as such may recommend, or of what the problem is that they are expected, as economists pure and simple, to solve. What is the problem?

To a producer it is that of finding a market for his goods and so enabling himself to keep on producing. To a consumer it is that of acquiring the goods he wishes to consume. Society must take an inclusive view, and regard the problem as one of maintaining the flow of goods from producer to consumer at as fast a pace as needs require and industrial capacity permits. To ensure continuous production and distribution is one of the two dominant tasks confronting society in the economic sphere to-day. We may state it even more simply: the task is to ensure continuity of distribution; for this being accomplished, production would look after itself. How to keep the cycle of production and consumption revolving steadily is the problem upon which our economists have concentrated their attention.

But society has another problem: it has to ensure that the distribution of the fruits of industry is carried out not only continuously but justly. That, at any rate, seems at first sight to be a separate problem, and is one with which most of our economists do not concern themselves. In my view the two problems are one, and cannot be separately solved. For the downward movement of the price level that produces trade depressions and unemployment is a reaction from and the result of a previous

upward movement; and the upward movement is the consequence of an unjust and uncovenanted diversion of income towards a particular class.

The objects of this book are: (1) To describe this diversion and its implications. (2) To propose measures appropriate to a short transitional stage during which this process is eliminated. (3) To outline a social order arising out of this reform in which our industrial resources can be fully and constantly utilized and prosperity become permanent.

Since the book is intended for the general reader I decided, after some hesitation, to begin with a very brief outline of the nature and circulation of money. Certainly there has been no lack of opportunity during the last few years for readers to acquaint themselves with these elementary facts. Still, it is just possible that one or two misunderstandings that persist in the minds of many new to monetary theory and practice may be cleared up.

The influence of Mr. R. G. Hawtrey will no doubt be detected in these earlier chapters. They must not, however, be regarded as an avowed attempt to summarize Mr. Hawtrey's views of the credit cycle; still less must that writer be held responsible for my proposed reforms. All the same, I know of nothing in these proposals that conflicts with established economic doctrine, however sharply they may be opposed to current social practice.

AUGUSTUS BAKER.

LONDON,
June 1933.

Certain portions of the first three chapters were originally published in 'Everyman' and the 'Railway Service Journal'.

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CHAPTER I

SIMPLE TRUTHS ABOUT MONEY

MONEY is a claim to goods and services. As a definition this would not pass all tests, but we shall find it a useful description of that function of money with which this book is mainly concerned.

Our money incomes represent the goods and services that would have to be supplied to us directly if money had never been thought of. The use of money permits goods to be collected in suitable places, such as shops, and acquired by consumers at their convenience in return for the money which embodies their claims. Goods must thus be capable of expression in terms of money.

There are, in fact, two such expressions. The money surrendered by consumers in exchange for goods is called the price of the goods. Money paid to producers for producing them is called cost.

Consumers must acquire a money income in order to be able to consume. For this purpose they become producers. Money is thus an incentive to production; but it derives this quality from being a claim to the product. The essential function of money is therefore to distribute the products of industry.

The object of producers is to dispose of their

output and recover the money claims to it. If the total price of the output equals the total income of the consumers, the claims of all consumers can be met and all the output distributed. Since the money income is earned in the course of producing this output, and in fact is a temporary substitute for the output itself, it would appear easy enough to secure equality between the money income on the one hand and the output expressed in terms of money on the other, and therefore to ensure that the output can be sold.

One reason why the process is not quite so automatic as this suggests is that the incomes of most producers are not received for producing just those goods which are available for consumption when the incomes are paid. A tanner, for example, may spend his week's wages on boots made from leather that he tanned several months ago. This, however, need cause no disequilibrium. Every week the tanner earns an income by adding something to the pool of goods, and by spending his income takes something out. That he does not take out the precise kind of goods that he puts in makes no difference. So long as a stable flow of goods and incomes continues, equilibrium is possible between the two.

Nevertheless we must attach great importance to the interval of time between the payment of incomes and the arrival on the consumers' market of the goods which these incomes were earned in producing. Though it need not cause disequilibrium it

permits other factors to cause it. For example, the total consumers' income, though it is earned by production, may change in amount without for some time causing a corresponding change in the quantity of goods available for consumption. Tanners may be discharged, or more tanners taken on, and the change is reflected in the quantity of leather in stock. The supply of boots may not be affected for many weeks, though the income of the tanners is affected at once.

If the consumers' income is enlarged it becomes more than sufficient to purchase the available output of finished goods. The price of this may be raised and yet it may all be sold. If the consumers' income is reduced it will be less than sufficient to purchase the available output at its current price. Either goods will remain unsold or their price must be reduced no matter what they have cost.

Money may be thought of as being pumped through the industrial system to those who contribute labour, thought, skill, the use of property, or any other service deemed necessary to production. In this way it becomes the income of the community as a body of consumers. The consumers pump it back in return for the available output of goods. Having returned, and paid the costs of production in doing so, it can be pumped out again to stimulate further production.

From this illustration it may be seen that, without any change in the quantity of money, its rate of circulation might vary. Consumers may spend

less than they have been accustomed to in a given time, or producers may reinvest less of their turnover in renewing production. These changes do take place, and their consequences are important. Of prior importance, however, according to the view here taken, are the effects produced by changes in the quantity of money; in fact it is these to a large extent that cause changes to be made by consumers and producers in the disposal of their incomes. If the quantity of money in circulation alters, the incomes of individuals alter, and with them the rate and nature of expenditure.

We shall therefore proceed to examine how changes occur in the volume of money, who makes them, and what consequences follow. But we shall not jump to the conclusion that if the consequences are evil those who make the changes are alone to blame. We shall ask why they make them; and at that point we shall have to question certain processes that are usually taken for granted.

Meantime, let us consider how money is made to vary in amount, and, to begin with, what we mean by money.

The money we first become acquainted with is pocket-money. At an early age most of us acquire claims to the goods and services that are obtainable for a penny. Silver coins are encountered next, and eventually we handle our first note. We may speak of all this money as cash; possibly we are learned enough to call it legal tender currency. In the course of a few years we become well

accustomed to handling currency, and it occurs to us that we should find it convenient to pay some of our bills by cheque.

To do this we must open a bank account, and perhaps we save twenty or thirty pound notes, as many a young man or woman has done, and pay them into the local branch of one of the Big Five banks. To maintain a bank deposit is for most of us simply to provide ourselves with a more convenient method of remitting money than sending notes or coins. In effect, we instruct our banker to send them.

Having opened our account we can now hand a cheque to the treasurer of our tennis club in payment of our subscription, leaving our bank and his bank between them to arrange for him to obtain the cash, if cash is what he wants. Probably he will leave the cash there, and instead draw a cheque himself in payment of new netting or whitewash, and the right to withdraw the cash is thus transferred to someone else, who may exercise this right in order to pay wages. But whether cash is demanded soon or late, the right to demand it is possessed by somebody all the time.

Looked at in this way, we might suppose that all deposits are represented by cash in the banks (cash meaning legal tender currency); and if every bank deposit were formed in the manner described, all the deposits in all the banks in the country could not together exceed the total amount of cash issued by the authority of the State, even if

everybody banked his money and all payments were made by cheque. Let us see, then, how the quantity of existing cash compares with the quantity of bank deposits.

The legal tender notes of all values existing in this country at the present moment amount to nearly 446 million pounds. We may regard this as the nation's total cash, for the silver and copper coins are in comparison quite negligible. Of these 446 millions, about 74 millions lie in the Bank of England unissued, only 372 millions being in circulation; and even this sum is not all lodged with the joint-stock banks (which are the banks we are concerned with), for some of us manage to keep a few notes in our pockets, and tradesmen have some in their tills and cash registers. Briefly, the cash held by the principal banks at the moment of writing is some 200 million pounds, including that which they are entitled to withdraw from the Bank of England.

Turning now to bank deposits, we find they make a much bigger total than 200 million pounds. If we put them at 2,000 million pounds we shall be near the mark. In other words, bank deposits are not only greater in amount than the cash which the banks hold: they are greater than all the cash in the country. Yet everybody who has a balance with a bank may quite correctly speak of having 'money' there. It is clear, then, that much the greater part of the money in use is not cash or legal tender currency at all. It is, in fact, bank

credit, and it is important to know how this credit is created.

If you are a manufacturer, and believe that the demand for the goods you make is likely to increase, you may think it advisable to anticipate the boom by buying more raw materials and engaging more workers. For some at least of these new commitments you will have to pay at once, though you may not get your money back for many weeks. You therefore ask your banker for a loan of, say, £1,000.

Now the banker does not run to his safe to see whether he has £1,000 in spare cash. So long as he has £100 or so to spare (or can easily get it) he will lend you the £1,000 you request, assuming that he is satisfied as to your integrity and so on. He could not of course do that if you were his only customer and £100 his total cash. But he has many customers, and knows from experience that, whatever your own particular requirements for cash may be, only a small proportion of any loan he makes leads to cash withdrawals.

In lending you £1,000, then, the banker does not exactly hand it to you over the counter. He permits you to draw cheques as though you had a balance with him to your credit. These cheques reach the people from whom you buy raw materials and go to swell their deposits. Perhaps you draw out a certain amount of cash to pay additional wages, but this soon reaches local tradesmen, whose deposits it increases when they pay it in. Thus

bank loans create bank deposits, which is one of the fundamental axioms of credit theory.

It must be understood that in allowing you to overdraw to the extent of £1,000 the banker does not necessarily increase by that amount the deposits he himself holds. Many of the cheques you draw will go to customers of other banks. These banks, however, are similarly making loans, some of which will reach customers of your own banker and be paid in to him. No doubt it is because each banker finds himself receiving large sums from customers to whom he has made no loans that bankers sometimes make statements revealing remarkable ignorance of the extent to which they create credit.

For example, bankers proclaim themselves to be merely the custodians of other people's savings, able to lend no more than their customers have deposited. To the manager of a local branch, with an outlook reaching no farther than his own books and safe, this may certainly seem a true statement of his functions. People open accounts with him and pay in money; his business is to lend it to sound borrowers at interest. Whether the money paid in is cash or cheques makes little difference to the branch manager. He can obtain cash from headquarters without question so long as his credit position is satisfactory. If most deposits are made by cheque, so are most withdrawals.

Still, he knows that he is not peculiar in handling a much greater volume of cheque-money than cash; every normal bank does the same; and it might

sometimes occur to him to wonder how all those cheques above the number represented by cash are accounted for. Some banker somewhere must have started the business of allowing cheques to be drawn against no cash at all.

The position would be clearer if all banking were conducted by one huge bank instead of five or six big ones and a few small ones. In these circumstances the balance sheet of our single bank examined at any average time would show, say, 200 million pounds in currency notes, and deposits amounting to 2,000 millions.

So 1,800 million pounds seem to have come out of the blue; only here the manager cannot blame the blue. No longer may he declare that much of the money in his charge reached him in the form of cheques drawn on other banks, for there are no other banks. These hundreds of millions are creations of money, not transferences of other people's money.

Nevertheless, there will still be the appearance of a balance between the sums deposited by his customers and the sums that he lends; for the borrowers can only use what they borrow by spending it, and those with whom they spend it can in these imaginary circumstances pay it into no other bank than the one that issued it. Thus the banker has two groups of customers: those who owe him the money he has created and are his debtors; and those who have subsequently received this money and, by depositing it, have become his creditors. As fast

as the banker expands his loans his deposits expand too, but in this case he could hardly fail to distinguish cause from effect. The loans would be plainly seen to be the cause of the deposits.

Bank deposits must be regarded as a sort of reservoir from which money circulates. This circulation is, of course, always going on whether the total volume of deposits is altered or not. During 1932, a year of bad trade, cheque payments amounting to 32,000 million pounds were recorded by the bankers' clearing house, which does not deal with all cheque payments.

When we think of money flowing out through the industrial system in the course of production and flowing back in the course of consumption, we must think of it as starting from the banks and returning thereto. It does not follow from this that every manufacturer or dealer is in debt to his banker. Many keep credit balances, but they are able to do so only because others receive bank loans. Whether a trader provides his own working capital or arranges with a bank to finance him depends to some extent on the nature of his business. Some maintain permanent balances, others have more or less permanent overdrafts, but the volume of the one is influenced by the volume of the other. If a manufacturer financed by his bank regularly draws cheques in payment for components supplied by an engineer who finances himself, the size of the engineer's balance depends, other things being equal, upon the continuance of these cheques.

Should the bank compel the manufacturer to reduce his overdraft he may allow his stock of components to diminish, and his cheque to the engineer will be smaller. Similarly, if the manufacturer perceives new markets for his goods, and is allowed by the banker to overdraw further, he may increase his orders and payments to the engineer.

Changes in bank loans thus affect the incomes of people who have never owed their banker a penny, and by varying the volume of money in this way bankers can produce quite remarkable results.

CHAPTER II

HOW SLUMPS ARE CAUSED

When the word 'money' is used in this book it must be taken to include bank credit, for this in every practical sense is money, though created out of nothing by the banker. Not only can the borrowing manufacturer spend his overdraft upon steel or oil or anything else that he requires: those whom his cheques reach can similarly spend their amount on copper, coal, lamb cutlets, or any other goods and services available. Bank loans, in short, become purchasing power, precisely as though they were currency notes, into which they may be converted at the will of depositors; and because the amount of these loans is so much larger than that of currency notes it follows that by far the greater part of the purchasing power in circulation to-day is issued not by the State but by the bankers.

Is the banker, then, a sort of counterfeiter? Does he resemble the man who coins spurious half-crowns or engraves false bank-notes, conducting these fraudulent operations in millions instead of hundreds, and in a commanding edifice instead of a secret cellar?

The banks themselves give colour to the suspicion that their creation of money is a shady business

which ought to be concealed as far as possible. The ratio of bank deposits to cash, as we have said, is about ten to one; but you would not think so if you merely studied the banks' yearly balance sheets. Those documents show the ratio to be less than seven to one, a result which is partly obtained by special measures taken by the banks at the time when the balance sheets are prepared. The process is known in the City as 'window-dressing', and was condemned by the Macmillan Report.

But suppose we were to ask a banker outright whether he did not regard himself as virtually a counterfeiter, what would he say? Having recovered from his indignation (for the banker is an honourable man, quite as honourable as many of the people who condemn him), he might advance two arguments in his own defence. First, he would point out that the coiner of a false half-crown exchanges it for goods, thus consuming a half-crown's worth of the community's wealth to which he is not entitled. The banker, on the other hand, does not himself spend the credit he creates; he transfers it to producers, enabling real wealth to be increased. The banker simply exacts a small percentage of the sum involved with which to pay his own expenses and provide a reasonable return for his services. That these services are useful and necessary to the community, and thus deserve to be paid for, would be his second argument.

In reply, we should remind him that the law would not condone a coiner merely because he sold

his coins to someone else for a small sum. Neither shall we admit that the banker sets up an impregnable defence by proving that the money he creates has become necessary to our commerce. There have been other times in history when the circulation of clipped and spurious coins in notorious amounts has been tolerated for years because the growing needs of trade required more money than the State supplied; but the clippers and coiners, though their false money was allowed to remain, were themselves imprisoned or hanged.

Nevertheless it is perfectly true that the money now circulating through the agency of the banks is necessary to society, and cheques drawn against bank deposits provide a convenient method of making payments. We no more need to confine ourselves to cash for this purpose than we need to return to golden sovereigns, silver groats, or barter. The banks are therefore performing a service that would have to be performed by somebody. In taking this task upon themselves they have indeed usurped the State's prerogative of issuing the nation's money, but for this the State must share the blame with the bankers, many of whom fail to understand even now what a colossal usurpation it is. The position is becoming clearer both to bankers and public, and the bankers must realize that if they continue to discharge these functions, they do so by virtue of an implied charter from the State which obliges them to give an account of their stewardship.

This being understood, we shall not join in the angry cry that has gone up from those who, having recently discovered that the banks create money, feel quite naturally that a sort of fraud has been perpetrated against them. It is curious that this knowledge has begun to grow at a time when the charge brought against the banks by others is not that they create money but that they have not created enough. The deflation of credit which these critics condemn is a restriction of the quantity of money, and its consequences are unemployment, depression, and despair.

The deflationary process is a normal instrument of banking policy. The banks can start it by reducing loans to manufacturers and traders, and once set in motion it continues with fatal ease. The measures employed are simple enough. The rate of interest charged is raised, conditions are imposed with which a borrower is unable to comply, customers with standing overdrafts are asked to reduce them, and applications for loans are refused.

The first effect is to compel merchants and manufacturers to reduce their orders to each other. Those affected by curtailed orders find their profits diminished not from any fall in price but through a reduced turnover. The next effect is that production is reduced and workers are discharged.

At an early stage, therefore, we notice a reduction in the money distributed as income to the consumers. Fewer workers are earning wages, certain traders are reaping smaller profits. People

have less money to spend on consumable goods, the supply of which, however, as we saw earlier, need not for a long time be affected by a change in production as a whole, and in fact is usually the last to be affected. The consequence is that the consumers have insufficient money to buy the available output of goods—at its current price.

Now we all know that money is merely worth what it will buy. A given quantity of goods can be sold for a small or large quantity of money with equal fairness to everybody if the seller's costs are measured by the same standard. But in a large and complicated modern community you cannot suddenly alter the price of every commodity and the terms of every money contract by, say, 2 per cent because the quantity of money has decreased or increased by that percentage. The goods ready for sale at any moment have cost a certain sum. These costs have been incurred over a period of time, often a long period. Unless somebody is to lose money, these costs must be recovered when the goods are sold.

Prices, therefore, are not reduced at once; instead, goods remain unsold. Unsold stocks of goods lead to reduced orders to manufacturers, some of whom may now be affected for the first time, not having themselves had any difficulty in obtaining bank credit. These will now be likely on their own initiative to reduce their borrowings. Why should they pay interest on larger loans than they can

profitably use? They too curtail their orders for raw materials and discharge workers.

By this time prices will be moving downwards. Some producers are able by superior efficiency to sell at lower prices, others must do so to obtain money with which to meet their creditors; many carry on with a reduced staff, hoping for better times; some go bankrupt.

The movement started with a disequilibrium between money and prices, but the continued fall in the price level does not automatically check it at any point that can be predicted, for every manœuvre made to deal with the situation reduces the consumers' income again and forces prices farther down; and falling prices themselves impose a check upon expenditure. A merchant who finds it hard to sell profitably the stocks of goods he holds because prices have fallen since he bought them will hesitate to order more. If his stocks are financed by bank loans he can reduce his loans and his interest charges by letting his stocks run low. All the more will he be encouraged to do this if manufacturers' prices are tending downwards, for the longer he waits the less his replacements will cost. The manufacturer likewise retards his orders for raw materials; he waits till prices fall, and in consequence fall they do. But the costs of production do not all automatically descend with falling prices, and in consequence many producers find their profits dwindling or vanishing entirely. They must economize, in their businesses certainly,

and probably in their personal expenditure as well.

Meantime vigorous attempts will be made to force down wages, and much less vigorous ones to reduce debt charges such as those represented by debentures. High taxation necessitated by falling taxable income and expenditure, and by the rising cost of unemployment benefit, will also be strongly attacked.

Long before the depression has reached its trough it will be noticed that the rate of interest is low and the banker will be denying responsibility. He is perfectly willing to lend money to sound borrowers, he explains, but the sound borrowers will not apply. Not only is there thus a lack of opportunity to create new deposits, but the deposits already standing to customers' credits are abnormally idle. People are not spending as freely as they might, either upon goods for consumption or materials for production. The velocity of circulation has slowed down, and for this, says the banker, consumers and producers are responsible. The banker may make loans, he may increase the quantity of money available, but once this money has passed out of his hands into those of the consuming and investing public it is out of the banker's control. Its holders may spend or hoard as they please.

Enough has been said already to show that this excuse is not valid, at any rate as an explanation of the sort of declension just described. It is true that a person may decide at any moment to alter

his mode of living, including the rate and character of his expenditure, for reasons that have nothing to do with banking policy. A consumer may save more than he has been accustomed to out of his income, a producer may diminish the scale of his operations by withholding working capital from his business. They may also change their habits in the opposite direction. But when we find such changes being made all in the same direction on a large enough scale to produce a disastrous effect upon industry, we naturally look for some other explanation than a coincidence of personal caprice.

We have already seen that the unanimity of action is no coincidence. Producers keep money idle because declining demand discourages them from investing it. Demand is declining because consumers are spending less; they are doing that because they have less to spend; and the contraction of their incomes results from the monetary contraction carried out by the banks. Once they have started this movement the bankers can fold their arms and watch it gather speed with little or no further action on their part. Having initiated a policy capable of throwing millions out of employment and reducing sound concerns to bankruptcy, they may then remark correctly enough that those who remain solvent seem strongly disposed to hang on to the money they have and very reluctant to start new enterprises. Men will not risk their savings in producing goods for markets already glutted. They will not borrow from banks at

interest for the same futile purpose. No more commitments for them till trade revives; the velocity of circulation of their money, at any rate, will remain as near zero as they can keep it.

Now this attitude, and the economic conditions from which it arises, cannot be particularly advantageous to the banker, who after all is a man of business himself. It would pay him best, one would think, to let industry have all the money it could use at all times, and since he plainly does not do this we must discover by what principle his monetary policy is guided.

Why does he restrict credit? Not particularly why has he done so during most of the last twelve years; we are seeking permanent causes and permanent remedies; there have been credit deflations before that rather complicated era, and there will be others again if we muddle out of the present depression in orthodox ways. We want to discover how a deflationary policy will end the next boom if we allow it to; and when we touch upon booms we are approaching the origin of the credit deflation that forms part of the normal trade cycle.

For a deflation is the reaction from a previous inflation; a trade slump lies latent in every boom under existing conditions; the banker restricts credit to correct certain embarrassing consequences of a previous credit expansion. We must see what these consequences are, and why they embarrass the [illegible]ker.

CHAPTER III

A WORD FOR THE BANKERS

A TRADE boom works by the same mechanism as a trade slump, but in the opposite direction. Its characteristics are a more rapid expenditure, a greater volume of money in circulation (which is another way of saying an expansion of credit), a growing demand for goods, less unemployment, and rising prices.

We saw that the bankers can start a slump very quickly by contracting credit. They may not so easily check the slump and start a boom, though an expansion of credit can be just as effective as a contraction once it gets going. The difference is that whereas a banker can reduce loans merely by refusing to lend, he cannot increase them unless people are willing to borrow. Even this need not be an obstacle; there are always willing borrowers of a sort, though perhaps not the sort the banker favours.

A boom may conceivably be started by increased expenditure out of accumulated savings; people grow tired of old clothes, shabby rooms, and worn-out cars. It could be assisted or even initiated by Government expenditure financed by bank credit. But no matter how it is started, an expansion of

induce a general desire on the part of his customers to withdraw their deposits is a suspicion that the banker cannot meet the demands for cash already being made. A depositor who learns that others are withdrawing their money on an abnormal scale hastens to join the queue. Hence the banker's anxiety not to arouse the slightest suspicion that his reserve of currency is smaller than it ought to be.

Runs on banks have taken place abroad quite recently; in England they have been frequent enough in the past. One is inclined to regard our bankers as more nervous than they need be. Certainly there were people during the crisis of 1931 who confessed to holding far more currency notes than they usually did to be on the safe side, but their number was insignificant. In France and America cash hoarding took place on a large scale; in this country there was very little of it. Still, the possibility of exceptional demands for cash is always lurking in the banker's mind, and sets a limit to the amount of credit he can issue. When he approaches this limit he will curtail his loans.

The banks that conduct these operations are the joint-stock banks, which through their many branches advance credit to merchants and producers all over the country. Their. cash is kept partly in their own tills and safes, and partly on deposit at the central bank, that is, the Bank of England, which is the bankers' bank among other things.

The joint-stock banks can replenish the currency

they keep for day-to-day use by drawing on their deposits at the Bank of England, just as a private citizen can draw on his own bank to provide cash for domestic expenses. But if the joint-stock banks began to draw excessive amounts of currency, action to check them would be taken by the Bank of England; and this would be done long before the banks had exhausted their deposits. For even the Bank of England does not hold enough currency to pay all its depositors.

It has two instruments which enable it to influence the joint-stock banks' capacity to issue credit. It may raise or lower the bank rate, and sell or buy securities. The bank rate is the rate of interest charged by the Bank of England itself for certain kinds of loans, and influences the rate of interest on loans generally. A rise in rates will discourage borrowers to whom the price they pay for loans is a matter of importance. It has other effects which do not much concern us here.

The sale of securities withdraws money from circulation in another way. When the Bank of England sells securities in the open market the buyers normally pay for them by cheques drawn on the joint-stock banks in the Bank of England's favour. The banks meet the cheques out of their deposits with the Bank of England, and since their deposits are thereby reduced, so is their ability to call for cash.

Armed with these two weapons, the Bank of England controls the quantity of currency and

credit in circulation; and a time comes in the course of a trade boom when it exercises this control to curtail the quantity. Why?

Because the quantity of currency that may be issued is limited, and is determined not by the banks (though the central bank issues it) but by the law of the land and the decisions of the Government. Above a certain fixed sum the central bank is allowed to issue currency only up to the amount of the gold it possesses. The fixed sum is based not upon gold but upon certain gilt-edged securities. It is called the Fiduciary Issue (an issue based upon faith) and its amount is fixed arbitrarily by Act of Parliament, provision being made for alteration when need arises. Alterations are not lightly made, and the fiduciary issue tends to be rigid. Its amount was fixed at 260 million pounds when we returned to the gold standard in 1925 and, after being temporarily raised by 15 millions in 1931, was restored to 260 millions at the end of March 1933. Above this sum the Bank of England must hold a pound's worth of gold for every pound note issued.

At the moment the currency issued amounts to about 446 million pounds. The difference between the fiduciary issue and this sum owes its existence to the presence in the Bank of England of gold to the value of about 186 million pounds. If the Bank acquires more gold it may issue more notes; if it loses gold, notes must be cancelled. This relationship of cash to gold was not destroyed by the suspension of the gold standard.

So long as gold flows into the Bank from abroad credit may be permitted to expand, for the currency drawn into circulation can be issued on the strength of the increased gold. But an expansion of credit produces conditions that are much more likely to drive gold out of the country than to draw it in, especially when a gold standard has to be maintained. For gold leaves a gold-standard country when it owes to foreigners more than they owe to it, which is likely to be the case if its imports increase and its exports decrease. Such an unfavourable trade balance tends to be produced during an expansion of credit in three ways.

First, since more money is being spent on goods in general, more will probably be spent upon foreign goods among the rest, especially by a country accustomed to buy largely from abroad. Second, the rising level of home prices enables foreign producers to sell in England goods which at the former price level failed to yield them a profit after carriage and duties had been paid. Third, the higher prices ruling at home raise some of the costs of production here, and manufacturers have to charge more for the goods they export. Foreigners therefore buy less.

Even without a visible rise in prices an adverse trade balance may be created during an expansion of credit. While not raising prices a producer may fail to lower them when improved methods would permit him to. Through this he loses some of his export trade to rivals in countries where prices may

balance. Nevertheless some restriction will be required to keep the quantity of currency within legal bounds.

An expansion of credit, then, puts a strain on the currency, directly by drawing more into circulation, and indirectly by reducing the gold on which it is based. The legal limitation of currency compels the banks sooner or later to check the credit expansion.

The unversed reader might be excused for inferring from these facts that a certain hostility must exist between the bankers and the Government, the bankers desiring either the dissociation of currency from gold or a higher fiduciary issue to provide cash in support of their loans, and the Government resisting the demand. Such, however, is not the position. Conflict between bankers and governments has certainly taken place, but usually it is the Government that desires to print more money and the bankers who oppose the policy. In grave emergencies like wars the banks have to submit; sometimes even they welcome more currency for their own safety; but in general their counsel is in the opposite direction, and prevails. The monetary policy pursued by this country during the last twelve years in particular, with its persistent effort to tie the currency to gold and restrict its amount, has been that laid down by the bankers, though with some dissenters. Why, then, do the bankers, though the amount of business they can do depends on the strength of their cash reserves, favour measures calculated to weaken them?

They do so from a variety of motives in which fear, tradition, ordinary human conservatism, and a desire to retain their profitable foreign business are combined with a real though misdirected sense of public responsibility for which they are not always given credit.

Though recognizing that the creation of currency is a prerogative of the State, they yet doubt in their hearts whether any Government should be trusted to meddle with it. They fear, not without historical justification, that the creation of paper money may get out of control. Once allow a Government to pay its way and extricate itself from difficulties by the easy method of printing paper, the bankers murmur, and nobody knows where it will stop. Paper money begins to be distrusted; it is too easily acquired; there is too much of it about. Merchants indeed find much to rejoice at for the time being. Buyers are plentiful; trade seems to thrive; goods fetch high prices. In fact after a time people with goods to sell do not readily part with them except for larger and larger quantities of the growing volume of notes, which depreciate in value the more numerous they become. The final stage is a frantic race between printing machines and prices, with paper money barely worth the cost of its own production. Bankers have witnessed calamities like this abroad, and as the custodians of our own monetary system they want to save us from similar disasters.

Perhaps they do not seriously think them likely

to overtake England; an expansion of currency is not obliged to get out of control. But what they do fear, and with reason, is that foreigners may not be so sure of us; and foreign distrust of British financial policy means the sudden withdrawal of funds from London, which aspires to remain the world's banking centre. There is little doubt that the raising of the fiduciary issue in 1931 caused alarm abroad and accelerated that withdrawal of foreign balances which forced us off the gold standard. 'Inflation' was the cry raised in financial circles everywhere; and inflation to a banker, especially to foreign bankers who seem more stupid than our own, means any expansion of currency not backed by gold. They even apply the term to a condition in which a given quantity of currency is maintained after gold has been exported.

By inflating in either of these senses we warn the foreigner that our money is not so rigidly anchored to a scarce and costly metal as it was, and he too wonders where the relaxation will end and into what financial catastrophes it will land us. Meantime, he thinks it wise to ask for his own money back. Foreign bankers and brokers keep balances in London for their own profit and convenience; but they will only leave them there so long as they deem them safe.

The withdrawal of these funds has the same consequences as a transfer of money abroad through an adverse trade balance. Either we lose gold and must cancel currency, or, in the absence

of a gold standard, sterling may depreciate indefinitely.

Suppose we were to let it depreciate? What will happen if the State encourages the bankers to issue all the credit that industry seems able to use, assuring them that new currency notes will be issued as fast as they are called into circulation? The trade boom that an expansion of credit produces need not then be checked by a feared or actual shortage of currency. All that would happen, it seems, is that the currency would continue to depreciate in both senses of the word: it would buy less foreign money (and consequently less foreign goods) and less home-produced goods. In short, its purchasing power would steadily diminish.

A depreciating currency does not affect all classes alike. Profit-makers gain, since it is their profit, as we shall see, that causes the monetary depreciation which consumers as a whole experience. People whose incomes are fixed by contract, or by arrangements not readily altered, suffer loss through being able to buy less with their money. These include pensioners, holders of fixed interest-bearing securities, and many salary earners. The great majority of wage earners are in the same category. They gain, it is true, by being employed in larger numbers, but only those whose earnings are based on a satisfactory sliding scale sustain no loss of purchasing power. Most workers have to fight hard for increases in wages, and even the most strongly organized can seldom keep their earnings level with the rising cost

of living. Credit expansion means a series of strikes, as credit deflation means a series of lock-outs.

If, therefore, we propose to create a perpetual boom merely by credit and currency expansion, issuing more and more currency as prices soar higher and higher, and risking the possibility that the depreciation may take a catastrophic plunge, then either we must face an era of perpetual injustice and strife, or we must alter the methods by which the remuneration of the various classes in society is determined. Such an alteration, to achieve its aim, would involve a drastic interference with what are deemed individual rights. Many are coming to believe that some such interference will be forced upon us. But if we are prepared for action so radical as this merely to spread the consequences of a depreciating currency equitably over the community, perhaps we may find that a reform no more drastic can prevent the depreciation occurring.

The depreciation is caused, we have seen, by a rising price level. In fact, the depreciation *is* the rising price level. To say that prices are rising is the same thing as saying that money is depreciating. We can stop this process, as we know to our cost, by reducing the quantity of money. That also puts a brake on industrial activity and causes unemployment. But cannot we issue an adequate quantity of money and yet guard against its depreciation? Before proceeding with this inquiry let us sum up the principal conclusions we have so far reached:

(1) Most of the money used in a modern State

is created by the bankers, who can vary its amount.

(2) Unless the quantity of money is adequate to the requirements of trade, our industries are less active and less fruitful than they might be, and the distribution of their products is hindered.

(3) This adequacy is never fully reached; moreover, at recurring intervals the quantity of money is subjected to special restrictions, causing unemployment, waste, and social distress.

(4) Whatever the requirements of trade may be, the banks' capacity to create money is not unlimited, for more money draws more currency into circulation, and the quantity of currency is limited by law.

(5) The bankers nevertheless assent to a restrictive currency policy, and in fact are largely responsible for it. Though the consequences of this are evil, their motive is to avoid other evils which they fear more.

(6) In any case we cannot cure our economic ills merely by creating as much cash and credit as industrialists fancy they require. To do that alone would permit a continuous rise in prices, necessitating a repeated adjustment of incomes and contracts, the constant correction of injustices between individuals and classes, with foreign trade becoming ever more difficult, and with the possibility always present of the currency depreciation attaining catastrophic speed.

(7) Most of these phenomena do in fact to some

degree accompany an expansion of credit, and sooner or later bring it to an end.

The most important factor in this train of events is the rising level of prices. It would seem, then, that if prices could be prevented from rising while an expansion of credit took place, one of the greatest bars to prosperity would be removed.

The main purpose of this book is to show that this achievement is possible, and that the prevention of slumps is not the only advantage that would be gained.

CHAPTER IV

WHY PRICES RISE

It may sound frivolous to say that prices rise because somebody raises them, yet this expresses a truth that is often ignored. Not by some blind and impersonal force that people are powerless to resist are prices put up when money becomes more plentiful. They are put up by the decisions of human beings.

Suppose that all of us have a little more money than we are accustomed to, and resolve to spend more freely. It may happen that there are not sufficient goods ready at the moment to supply our new requirements, for nobody knows exactly what kind of goods we are going to indulge in till we ask for them. Very well, we may say; some of us must wait and keep our money in our pockets. Exactly who shall wait and who be served at once will be settled in a haphazard sort of way, and we may think this rather unsatisfactory, but that at any rate—so one might suppose—is all that would go wrong. Either we should receive more goods proportionately to our increased incomes or we should retain the increase in money.

But that is not what happens. Certainly some of us must wait before our new demands can be

ninety-nine people out of a hundred regard it as inevitable and in the nature of things that this rise should take place given growth of demand.

It is a principle upon which many economists during a depression base their hope of better times. They agree that more money should be circulated; they want this to be done for the express purpose of producing a rise in the price level. They know that an appreciable increase in the circulation of money will raise the level of prices without further ado. Referring to this principle in its most generalized form, they would call it the 'quantity theory of money'. One famous economist said recently that the plain man wants to hear as little as possible about the quantity theory, and we certainly need not discuss its intricacies here. But, after all, the quantity theory is only the law of supply and demand in disguise, and under that name will not greatly alarm the reader. For of all the laws of nature or man ever formulated this is one that the plain citizen thinks he can understand and accept without question. But we are going to ask him to question it.

The new money that sends up the price of goods already on the market is that which is being distributed in the course of increasing our capacity to deliver goods later on. Because we are expanding credit to electrify transport, build new factories, make new machines, and improve roads, the boot manufacturer is able to charge us more for boots, the piano maker for pianos, the motor engineer for

cars, and all kinds of producers for all kinds of products, though they have cost not a penny more to produce.

At this point an objection will be lodged. Is it true that the cost of producing these goods has not increased?

Obviously no costs have increased if no prices have; for one man's costs are another man's prices. The costs of a manufacturer are the prices charged by some prior producer for raw materials, semi-manufactures, replacements of machinery, and so on. Until somebody raises the price of something no costs can go up. Theoretically the price of labour, which is also a cost, might go up first and explain all the rest, but nobody would seriously advance such a theory. Our more doctrinaire economists may deplore the power of organized labour to resist wage reductions during a slump; not one of them would declare that wage increases first force more money into circulation and start a boom. Wage increases follow rising prices; they do not account for the first upward movement.

A movement of prices is plain enough as a whole, just as the movement of a car is, but it is not easy to study the many detailed motions of which the whole is made up. The movement is the combined result of a vast number of individual decisions. To discover how these decisions are reached requires imagination, but we must attempt it.

After a long period of depression, let us suppose, a manufacturer receives one morning an unex-

pectedly large order from a wholesaler. This proves to be no mere flash in the pan; orders continue to grow, and the manufacturer realizes that he must replenish his stock of raw materials, of which lately he has bought no more than he can help. But this manufacturer is not the only one increasing his orders for primary products; others have been stimulated to act in a similar way, and in consequence the world's mines and quarries and foundries and blast furnaces are enjoying a general revival of demand.

Now primary products are very sensitive to fluctuations in demand. Their price goes up at once, and our manufacturer, partly because of the actual rise and partly because he knows from experience that it may soon be accentuated, raises the price of his own product to the wholesaler, especially as the growing insistence of the wholesaler's demand encourages him to think that the higher price will be paid without demur. But the question has only been put back a stage. Why was the price of raw materials raised?

Well, we must admit that because of that responsiveness to changes in demand just mentioned, the price of these products during the depression we are assumed to be leaving was extremely low; in some cases it fell even below cost. Nobody would blame producers now for trying to recover their costs and leave themselves a margin. It is here, then, that the rise may begin, and a rise of some dimensions certainly seems justified.

lift us out of depression, while rejecting their assumption that prices must be allowed to rise till dangerous symptoms warn us to impose the usual checks.

But if prices are not to rise, and if they are not to be prevented from doing so by a limitation of money, they must be prevented by authority. In plain English, prices must be directly controlled by Government.

Perhaps this may not seem to everybody quite such plain English as it looks. What has the Government really to do? Has it to fix a legal price for every commodity and be prepared to prosecute any shopkeeper in the land who through ignorance or avarice charges a different one? And will not this restriction on prices, which is in effect also a restriction on profits, prevent that revival of industrial enterprise without which an expansion of credit, even when the banks are ready to permit it, fails to impel new money into circulation?

These doubts are understandable. The changes proposed in our economic arrangements are rather drastic, and any plan for a new social order must include the means for its own establishment. Without that, not only will it fail to receive general assent: it will fail even to be generally understood. To know the arguments in its favour, to know what society will look like under its influence, is not enough. We want to be told exactly what a Government must do, using as far as possible the instruments normally at a Government's disposal,

to transform society from what it is into what it ought to be. In fact, to many of us a reform of any dimensions does not begin to look practicable until a political party has embodied it in its programme, and not always then if the party is not our own.

Since I believe that the permanent remedy for our economic ills demands resolute Government action, perhaps it will not be amiss if I endeavour to show how a Prime Minister, supported by a majority in the House of Commons and determined to apply this remedy, might announce his programme to a surprised public.

But a Prime Minister must belong to a party, and I am not sure to which party he should be assigned. At the moment of writing there are quite a number of parties and sub-parties to choose from, most of them in a fluid state and likely to lose their identity at short notice. On the one side the party which traditionally stands for stability rather than experiment has initiated the most drastic change in economic policy effected by this country for three generations; on the other side the parties of the left have shown a marked reluctance to initiate anything.

The programme about to be announced might be adopted to-day by any party, and I need not declare which one I presume to be so bold. Certainly a Prime Minister could hardly make an important speech on the morrow of a general election without affording some hint to his party label, and for my

own guidance I have settled the point by reducing the parties to three and spinning a coin in the air three times on the 'odd man out' principle—the odd man in this case being 'in'—confident that the reader, whatever his own political allegiance, will accept the verdict like a stoic if he gleans a clue to the anonymous Prime Minister's party colour and finds it different from his own.

Needless to say, this Prime Minister is no one known to me in political life or outside it: he is an imaginary person.

Now I ask the reader's indulgence while the unknown Prime Minister comes to the microphone and describes how he proposes to restore prosperity and do what can be done in the course of a session or two to ensure its permanence. On the foundation that he will lay down we shall try afterwards to erect the framework of a new economic order.

CHAPTER V

A VOICE FROM THE FUTURE

THE time is evening, during the depression. The scene is any reader's home. Still full of the excitement aroused by the general election that we must assume to have just taken place, he has switched on his wireless set to hear the latest developments.

'The Prime Minister!' he hears the announcer say, and a voice begins to address him and the listening country.

THE UNNAMED PRIME MINISTER: The crisis that caused the general election of last week, resulting in the return to power of the party I have the honour to lead, was a political crisis. It arose from dissensions inside the late Cabinet and from the conviction forced upon every minister that the public was gravely dissatisfied with the performances of the Government.

That crisis has passed. There are no dissensions in the new Cabinet. But the economic emergency that the late Government failed to alleviate remains, and we shall be judged, I am well aware, by the vigour and skill with which we handle it. I believe that this emergency will not be with us long. Our plans for removing it require your co-operation, and, relying upon that, we are going to

put them into execution without delay. I mean by 'without delay' to-morrow morning. Within a week the benefits of our policy will begin to be felt; within a month they will be widespread. Within a year, it is my belief, a great transformation will have become apparent throughout the country, to the advantage of us all.

You may be surprised and perhaps incredulous when I promise so much so soon. Yet it should not be surprising if we look at one or two facts that have long been staring us in the face. Let me make myself quite clear, first, as to what I am promising.

To those who have goods which they cannot sell I promise that they shall find markets; not indeed instant markets for every ounce of goods in their store-rooms, but for enough to make a vast difference to their outlook and their future activities. To those who wish to buy goods and have no means, I promise the means; not unlimited means, but enough to ensure a reasonable and progressive standard of living. To most of those who are in neither of these positions—to those whose incomes are adequate to their needs and whose only anxiety is that these incomes may not continue—I promise that they will at any rate be made no worse off than they are to-day by the measures we shall adopt, and that eventually they shall share in the prosperity which is possible for us all.

Is it really strange that we should profess to be able to transfer goods from those who do not want them to those who do? It would hardly seem so

to a people that had never learned to use money. But is it not a stranger thing that money, which is intended to facilitate the exchange of goods, should have come to hinder it? For everybody agrees to-day that money has much to do with the evils that now so harshly afflict us.

The ordinary citizen would say concerning money that there is not enough of it about. We may take that as a rough expression of the truth. Money is needed to sell the goods that can find no buyers and to set the unemployed to work in replacing them. Now most people know that the money we use to-day can be produced quite easily in any quantities. The notes you receive in your pay envelopes and spend upon your household needs, the cheques that many of you use for larger purchases, cost little to print. Neither are these pieces of paper symbols of any more valuable kind of money that lies hidden in banks or in the State treasury. There is gold in the Bank of England, but its amount is trifling compared with the money in circulation even now.

Of course we cannot add to our real wealth (that is, to the goods and services available) merely by printing notes or writing cheques. But we can make it impossible to distribute this real wealth by destroying these notes and the power to write cheques, and that is what we have been doing for some years. In the same way we can make it easy to distribute goods and services, so long as we have them to distribute, by seeing that an adequate

quantity of money is in circulation. That is what this Government proposes to do.

There is nothing novel about that; it is the way in which slumps are normally ended sooner or later. There is nothing revolutionary about it either; for some time now it has been proposed by many economists of quite moderate political views. It is called inflation. But because this slump is more severe than any normal one, and because we are determined to end it sooner than it would end itself by normal means, the measures that we shall adopt to increase the circulation of money will include some that will not meet with the approval of the more conservative economists. And because we wish the era of prosperity that we believe we shall inaugurate to endure, we shall accompany our expansion of money by certain other measures that are indeed novel in character. To these I shall return in a moment. Let me first explain briefly our plans for expanding the nation's stock of money.

Money normally gets into circulation by means of loans from banks to manufacturers and merchants, who use it to buy materials and pay wages and salaries in the course of producing and distributing goods. Those who receive this money from the borrower, whether as wages or in payment for materials supplied, naturally spend it, in most cases pretty quickly. (When they do not, difficulties may arise which do not concern us to-night.) The worker spends his earnings on domestic goods, the supplier of materials spends what he receives partly

on the wages of his own workers and partly on other materials. In this way money which the banks issue as loans to stimulate the production of goods also stimulates consumption. Or I may express it in another way. The money put into circulation in the manner I have described permits more goods to be consumed, but it also ensures that other goods shall be produced at the same time.

Now the Government intends to use this perfectly normal means of putting into circulation much of the new money that is required. The joint-stock banks will increase their loans to industrialists. They have indeed been willing to do so for some time, but two things have stood in their way. Producers who were most willing to borrow this money were as a rule in charge of unsound concerns, judged by a banker's ordinary standards; and those whose businesses remained sound were unwilling to borrow money with which to increase their output, for they had no expectation of selling any larger output.

To-night I ask those sound borrowers, who in almost every case are in control of plant which is at present working far below its capacity, to take a brighter view of the industrial outlook. Let them engage more men and order more materials, borrowing from the banks to do so, being assured that the new economic policy of the Government will justify their courage. I hope to convince them to-night that this is so.

A similar request I make to wholesalers, many

of whom have for months been holding smaller stocks of goods than they hold in more prosperous times and reducing the loans from banks with which they buy them. I urge them to order a little more freely from manufacturers and expand their stocks. Very soon they will find this expansion necessary if they are to fulfil the orders that will come from retailers when the new money reaches consumers and is spent.

There remain those producers whose businesses are in a bad way. To well-established concerns that were prosperous a year or two ago, and have been brought down by the depression, we shall afford help. Let their directors state their case fairly and apply to their banks for loans. They will find the banks more sympathetic than they have been of late, and ready to extend reasonable assistance. We have had conversations with representative bankers, and have convinced them that they must take risks. In certain eventualities the Government will give them financial guarantees.

These, then, are our plans for distributing money through the ordinary channels. Their very adoption assures their own success if our view is correct that a more rapid circulation of money is what is needed to restore our industries to activity and our country to prosperity. Bear this in mind, you merchants and manufacturers who may yet lack confidence.

Now by the measures I have just described we may or may not get into circulation within a

reasonable time all the money that can be usefully issued. Perhaps the confidence I have asked for may not be forthcoming just yet. In anticipation of this the Government proposes to distribute money in other ways as well. But we have reasons for doing this apart from the need to expedite our general plan.

There is want among the people of this country, ladies and gentlemen. It seems a strange thing that citizens can be hungry and ill-clad and anxious because we produce too many goods, yet that is what their condition amounts to. I will not enlarge upon that, though among those now in the House of Commons to whom I look for support—no doubt they exist in all parties—are men who have long been broken-hearted because of their impotence to abate the needless hardships that so many have suffered from the beginning of their lives to the end.

From the first pay day after this week unemployment benefit for every class of recipient will be restored to the figure at which it stood prior to the reductions made in 1931. Soon we shall increase the benefits. We do this all the more confidently because we know that the number affected will fall before long to a negligible figure.

The pay of all Government servants reduced during the last two and a half years will be restored to the figure at which it stood before the reductions took place. These restorations will take effect next month.

During the next few days we shall make substantial grants to all hospitals.

Through the almoners of hospitals, through charitable organizations, churches, and other bodies, we shall try to get in touch with crippled and otherwise disabled persons who are not in receipt of unemployment pay or pensions, and are in need.

Various slum clearances for which plans have been prepared during the last few years will be put in hand almost at once. Approved town-planning schemes at present held up for lack of money will be supported. These two measures partake rather of the same character as those I described earlier. They are operations which in more normal times might expect to be financed to a great extent by loans from banks or other financial institutions, directly or indirectly. So they will now. But the grants in aid, the enlargement of unemployment benefits, and the restoration of pay to civil servants are in a different category. Where is the money coming from, you will ask, to pay for these?

Money expended by the State, as many of you know from experience, is mainly obtained by taxation. That does not mean that the Government spends no money till the taxes come in. We borrow money in advance, and repay it when the taxes reach us. When I say we 'borrow' it I really mean that we create more money—or induce the banks to create it on our behalf. For Government borrowing of this character is really an expansion of credit, and increases the money

in circulation for the time being—that is, till the taxes are paid.

In times of emergency, in war-time for example, we borrow (or create) money at a greater rate than we can recover it in taxes. To do that is called inflation. Many people call it the worst kind of inflation, for much of the money so created does not go to develop our normal industries and so increase the output of goods available to the consumer. Only a great emergency is thought to justify inflation of this kind, and a charge often brought against Governments is that they too readily resort to it rather than impose unpopular taxes.

Well, we are going to resort to this kind of inflation now. For we regard the state of the country to-day as one of emergency. I do not say that we shall never attempt to recover through taxation any of the sums we are going to spend at once upon social services, but we shall not do so during the current financial year, neither shall we provide for them in the next Budget. I am not among those who take a light view of an unbalanced Budget. I believe in fact that Budgets should be balanced even at some sacrifice; but not at all costs whatever. The steps we propose to take will eventually lighten the burden of taxation and render a balanced Budget easy to secure.

I would allay, if I can, the misgivings of those who sincerely dread the consequences of our inflation by reminding them that whereas during a war

a large part of the nation's resources must be devoted to the manufacture and transportation of armaments, entailing a shortage of goods for domestic use, which is augmented by the difficulty of obtaining overseas supplies, nothing of the kind affects us now. Manifestly there is no shortage of goods, nor of the means to add speedily to their quantity. The money that we intend to circulate will serve to distribute the goods with which the world is glutted, and stimulate their replacement.

Nevertheless I have to say that these latter proposals of ours have evoked serious opposition. I will not conceal from you the fact that for some time they stood in the way of an agreement between the Government and the banks. There came a point where we had to consider the taking over for the State of one of the joint-stock banks. The control of one large bank and its branches, combined with certain powers over the rest and the resumption by the Treasury of direct control over the currency issue, transferred to the Bank of England in 1928, might have given us all the power over credit that we require for our immediate purposes. Had it been necessary, we should not have hesitated to nationalize all the banks. In the end this necessity was for the present avoided.

Before proceeding, I wish to record with pleasure that from the outset of these negotiations we found the joint-stock bankers not wholly against us. From some, in fact, we received far more support than we anticipated, and no doubt the influence of these

powerful supporters was largely responsible for our eventual agreement. It is doubtful, however, if this would ever have been reached but for a very important part of our policy that I have yet to describe. To this I shall come later.

With the Bank of England our negotiations took a similar course. Only one member of the present Cabinet had previously had dealings with that institution, and we did not know what attitude it might adopt towards a Government less disposed than any in its history to defer to its advice. I thought it well to begin by laying down certain propositions, not because they were likely to be unfamiliar to the Bank authorities, but because I wanted them to know that they were not unfamiliar to us either. Those propositions were the following:

(1) That the power and status of the Bank of England are derived from Acts of Parliament which the present Parliament might repeal.

(2) That the functions performed by the Bank for the State could as well be performed by the State itself aided by any one of the joint-stock banks, whether nationalized or not.

(3) That foreign confidence in the financial soundness of Great Britain, the preservation of which has been in the past the primary object of the Bank's policy, is of no value to the people of this country except to promote their own welfare.

(4) That if the measures taken to preserve foreign confidence work ill for this country instead

of good, they will not ultimately even preserve foreign confidence.

(5) That the purpose of a financial system is to facilitate the distribution of goods and services.

(6) That the economic policy of the present Government being to afford producers full power to exercise their ability to produce, and to effect a distribution of their product satisfactory to consumers, the Government will assume any powers that may be necessary to prevent the frustration of this policy by the misuse of the nation's credit.

In support of our policy of rapid credit expansion the fiduciary issue will be raised as from to-morrow by 15 million pounds to 275 million pounds. This means that 15 million pounds more money in currency notes may be issued with no equivalent gold at the Bank of England. Any increase in bank loans is likely to lead to larger demands for cash which this step will enable the banks to meet.

No doubt it will provoke a flutter of alarm in bank parlours abroad. For this reason, and from their own habits of thought, our bankers also viewed with misgiving a policy likely to involve raising the fiduciary issue, though since the Government was determined upon that policy in any case, and in the end secured the bankers' compliance, they deemed it wiser that we should sanction the increase at once, thus proclaiming it a matter of considered and deliberate policy, rather than wait till the demand for currency compelled it.

The Government is prepared to double the

fiduciary issue and to part with every ounce of gold in the country if that becomes desirable in the interests of producers and consumers. As it happens, however, the demand for currency is unlikely for a considerable time to exhaust the supplies which we have now sanctioned. This is due to certain important measures which I must soon disclose.

CHAPTER VI

PRICE CONTROL MADE EASY

A PORTION of our imaginary statesman's speech must be omitted. We have given the substance of it in earlier chapters. He would explain the normal consequences of such a monetary expansion as that which he has announced the Government's intention to instigate; he would describe the rise in prices, the depreciation of currency, the growing distrust among foreigners; and no doubt he would call attention to the enrichment of those whose mounting profits force the price level upwards. At this point we may switch on his speech again.

THE IMAGINARY PRIME MINISTER: These accumulations of profit become themselves a factor in the monetary problem. They endow certain individuals with far more money than they can spend on their own needs or enjoyments; they are therefore disposed of in some other way, with varying effects on the social economy. I do not propose to pursue this branch of the subject now. It is not necessary to an understanding of our immediate policy.

That policy is to prevent the progressive rise in prices whereby these profits accrue. And our object in doing that is not mainly to prevent the unjust enrichment of particular classes in

society, though that is a worthy end; nor to safeguard pensioners and others with fixed incomes against the growing burden of a rising cost of living; nor to avoid the successive wage disputes that arise in the same circumstances from the same cause. All these things are evils which a responsible Government must certainly try to remedy or prevent, and incidentally the measures we are adopting will have that effect. But what we directly seek to do is to ensure that the country this time shall escape that reaction which sooner or later brings to an end any period of prosperity in which producers and sellers, as price-makers, are allowed to have their own way. This time, so far as it lies within the intelligence of man and the bounty of Nature to secure it, the prosperity we are about to enjoy shall continue.

We shall promote prosperity by putting into circulation, in ways I have already described, as much money as trade requires; we shall ensure its continuance by controlling prices. All that remains for me to do to-night is to announce the methods by which our control of prices is to be exercised.

Our intention to control prices was declared plainly enough by the members of the present Government during the recent election campaign. No doubt our friends were a little puzzled as to what procedure we should adopt, and our opponents were loud in their questions and criticisms.

Did we intend, they asked, to fix the price of every single commodity? On what principle would

the price be determined? How many weeks or months should we take to find the proper price of everything? Would it still be the proper price by the time we had ascertained it? Could we ensure the faithful observance of our edicts without putting a policeman in every shop? And here and there the voice of the dodo was heard in the land proclaiming the dire results that must follow any interference with some natural law that was never clearly stated.

I have already convinced my listeners, I hope, that prices do not follow any rigid natural law which human beings are powerless to affect. Whether the Government interferes or not, prices are regulated even now by the decisions of human beings. It is true that no individual or corporation can choose arbitrarily whether the price of a loaf of bread shall be twopence or half a crown; but neither does the Government propose any such absurdity. As to the difficulty of ensuring that the prices fixed by authority shall not be ignored, I may remind you that the people who sell commodities to the final consumer have very little say nowadays in fixing the price of them. They hand you goods in tins or packets or bottles, the price of which is not only fixed by some centralized supplier but is known to every customer. Shopkeepers are quite accustomed by this time to selling goods at prices fixed by somebody else. Why should they care whether the price is advertised by the proprietors in a newspaper or announced through the same

medium by the Government, so long as it yields them a fair return?

Prices are fixed nowadays, then, not by a vast number of small shopkeepers but by a comparatively small number of large dealers and manufacturers. So much the easier will it be, therefore, for the Government to negotiate, or, if necessary, to take legal action.

A quite genuine fear exists that the highly complicated schedule of prices which, it is supposed, the Government must issue will be difficult for the public to understand, and much confusion is expected to arise before the scheduled prices become familiar. There will indeed be schedules, but the apprehension arises from a misunderstanding of the object we have in view. The same misunderstanding has led people to exaggerate the task of determining what each price shall be.

Perhaps what I said a while ago may have cleared up this misunderstanding to some extent. Whatever we may do later on regarding profits, I want you to remember that our immediate concern is not directly with profits but with prices. Our present programme does not require us to substitute some other form of remuneration for the profits of which the incomes of some members of the community consist. Let them continue to reap what we may for the moment call a fair profit. But what we must do, and mean to do, is to prevent those exactions of *excessive* profits which, regarded hitherto as the normal accompaniment of monetary

expansion, progressively raise prices and at last cut prosperity short.

This being our object, and the year in which it has befallen us to attempt its achievement being one of depression in which prices are low and excessive profits virtually absent, there is even less need than there might otherwise be to tarry until a minute inquiry has been made into the cost of every commodity. We shall certainly undertake that inquiry, but we can act without waiting for its results.

For what we propose to do is to decree, by virtue of an Act that is passing through Parliament to-night, that all retail prices and all rents shall remain for twelve months at their present level. That is broadly the effect of the order we shall make. For precision, and for legal reasons, a schedule of retail prices has been prepared based on the prices ruling during the last six weeks. Where prices have fluctuated we have in most cases scheduled the highest.

The schedule will be published to-morrow morning in the principal newspapers and exhibited in post offices and public buildings. It may look a rather formidable document, but housewives and customers generally will have gathered by now that it will not bother them much. They can refer to it when in doubt, but they know what they have been paying lately for most things, and they will go on paying the same prices. Retailers similarly know what they have been charging, and must adhere to those

charges unless they have been charging less or more than the prevailing price.

I have said that the Order will remain in force for twelve months. The period may seem somewhat long; it has been chosen to discourage any attempt to hold up stocks, or any disposition to delay purchases, in the expectation of altered prices. Provision is made, however, for variations to be sanctioned in the prices of certain groups of commodities that are legitimately subject to seasonal fluctuations.

A schedule of wholesale prices will also be published. They are in many cases a little higher than the prices ruling now. A sufficient margin exists between wholesale prices and retail to permit this. Our departure in the case of wholesale prices from the procedure we have followed with retail prices, that of stabilizing at the present level, compels those affected to study our schedule; but people concerned with wholesale dealings are used to watching price lists, and attention to ours will not greatly trouble them.

We have not raised the wholesale price level so much as some will wish. It may be true that many producers can scarcely make a profit at all at the prices which have ruled lately; but it does not follow that they could not do so given a larger output and a steady market. The policy of the Government, taken as a whole, provides just those advantages.

I do not pretend that the regulation of wholesale

prices is an easy task. Still, I have reason to hope that we may accomplish it. The obvious difficulty, of course, is that of overseas products. We may, if we like, control the price of a commodity at every stage from raw material to finished article; but we cannot control the price of the raw material itself if it is produced abroad. In the first place, however, the world's stocks are at present high; producers everywhere are competing for orders. This country will now be prepared to place large contracts, and for some time yet is likely to find its orders gratefully received and executed on favourable terms. By long-term contracts and large-scale co-operative buying, in which the Government is prepared to participate, there is no reason why we should not continue to obtain satisfactory terms from overseas producers.

In this connection the Government is about to open negotiations with producers throughout the empire that are likely, in my opinion, owing to the new policy now being pursued by us, to be productive of far more good to the empire and ourselves than any imperial negotiations of an economic character conducted hitherto.

Meantime, if any injustice is inflicted upon producers or merchants by particular prices in our schedules, the Government is ready to hear of it. Correction will be made in proven cases, but the onus of proof will rest upon complainants, who must furnish us with the fullest information concerning costs.

But on the general question of the justice of stabilizing prices at their present low level, I must remind you that the Government did not place them at that level. They were there already. They got there by the operation of those 'natural' forces that many people hold in such reverence. And what do you think would happen to them but for the action which the Government is now taking? They might remain where they are; they might fall still further. True, they might also rise: depressions do not last for ever. But booms do not last for ever either; and in the absence of drastic and far-sighted action of just such a kind as the Government is initiating, booms in this country will certainly not attain the magnitude in future that they sometimes did while Great Britain occupied a unique position as a manufacturing nation. At the chosen level of prices, manufacturers and sellers generally are at any rate assured by our policy of a larger and steadier demand than they have hitherto had any reason to expect.

I said at the beginning of this talk that the Government asked for your co-operation. In particular we want you to be patient with any small hitches or hindrances that may arise during the next few weeks. We can imagine many; we can, I hope, deal with all; but we cannot foresee all and prevent them. It may be that your very eagerness to assist may cause some small troubles. For example, you may think it your duty to spend more freely than has been your habit of late, and

the result may be a temporary shortage of some commodities. This may lead to impatience, and even to fear that our plans are breaking down. Do not give way readily to such emotions, I beg you.

If I were asked to give a lead to consumers generally on this particular point, I should say: Do not refrain from any expenditure that you might have been almost ready to incur even had there been no change in the industrial situation; but do not regard it as your duty to be extravagant. Increased demand will come in any case from those who will now have a moderate income in place of a meagre dole or nothing. The Government will keep in close touch with the public through the press and by wireless and report frankly on every development.

Returning to the broader issues that our policy raises, it is little enough that we ask. We call upon producers and dealers to refrain from profiteering, and to be content with the enlargement of their profit that comes from an increased turnover. We call upon wage-earners—though with much humility, well knowing how they have suffered in the past from unfulfilled promises—not to press for increased wages during the next twelve months but to be content with knowing that more of their numbers are employed and that the purchasing power of their wages will not diminish. That is virtually all we ask. Citizens generally will go about their business of buying and selling, working and taking their recreation, very much as usual, but with

renewed hope. This is a great experiment that we are undertaking, worth far larger sacrifices than anybody is in fact called upon to make. It is not only an economic experiment: it is a political one; and perhaps we may show the world, now seeking refuge in changed forms of government, that society can transform itself from a condition of hardship and bitterness to one of prosperity and good will while developing, instead of forsaking, those principles of self-government and democracy to which this country holds fast.

CHAPTER VII

THE JUST PRICE

A PLANNED economy must start somewhere. Unless preceded by a destructive revolution it can only start at the point which society in its economic development has already reached. The plan must embody those new elements that are regarded as essential and are intended to be made permanent, but it may tolerate abuses for a time, and the transitional stage may require special and arbitrary provisions.

For example, the normal way of projecting money into circulation, even under a reformed system, may be through the productive organizations; yet this method may prove inadequate during the emergency which is presumed to have sanctioned the experiment. In choosing the avenues through which to issue new money in the first place, therefore, our Prime Minister has been shown to be guided by expediency. The important thing is to get more money circulating; to that end we may act upon any reasonable suggestions without committing ourselves to the theories of those who make them. So long as purchasing power is sufficiently increased trade will revive, and the revival will

stimulate all industries for whose products there is a real demand.

Similarly, the direct control of prices is essential to the plan, and is a permanent part of the economic order it is desired to establish. But the proposal to fix prices for the time being where they are is made on purely practical grounds. It is not assumed that the price which a commodity happens to exchange for in 1933, or whenever we may start, is necessarily fair to everybody and must never be altered. Later we may alter it; all prices are bound to be altered. But a period of stability is necessary first, and the only practicable level at which to stabilize retail prices is the one ruling when the plan is inaugurated. Anything else means delay and confusion. Once this level is established, the prices of particular commodities can be varied from time to time with no more trouble than the oil companies experience to-day in changing the price of petrol or the bakers in changing that of bread.

Twelve months is suggested as the period in which prices shall not be allowed to rise or fall. During this period neither society as a whole nor the Government in power should be held responsible for any injustice that the established price may inflict upon particular producers. In exceptional cases compensation can be made, but the producer must remember that the injustice of which he complains might have gone on, had there been no plan, until he was bankrupted. The process is quite normal, and many have suffered from it

already. There is reason to suppose that the present level of retail prices affords an adequate profit for everybody concerned, and would continue to do so though wholesale prices rose a little.

But the twelve months will pass. By then a more permanent plan must be ready. The control of prices is indeed a part of the plan, and to control them by law instead of by varying the quantity of money constitutes an essential distinction between the plan here proposed and most others. But the purpose of this measure as so far disclosed is merely to prevent prices rising during an expansion of credit.

A mere prohibition, however, does not constitute an economic system. We cannot simply leave prices where they are. If injustices exist or arise between one class of trader and another they must be remedied sooner or later; moreover, changes in costs will occur through improved processes and technique, and who derives the benefit from these will be determined by price control. Is there a just price? Is there a just profit? Perhaps we shall most easily ascertain the principle on which prices must be based by considering profits first.

A profit is a mode of remuneration. Society has various forms of payment for services, and while they may differ in amount there seems at first sight no difference in essence between the wages of a carpenter, the salary of a clerk, the commission of a commercial traveller, the fee of a doctor, and the profit of a manufacturer or trader. And in fact

of income, and at the same time disturb the monetary stability. We will call those whose incomes take the form of profits the 'traders',[1] including in that term manufacturers, wholesalers, investors in ordinary industrial shares, and entrepreneurs of various kinds. Since profits are apportioned by a different method from other payments, and we want to see the consequences of that difference, we will suppose that they comprise a quarter of the total income. If the community as a whole receives £2,000 in a given period, the traders receive £500 of it, which is tacitly assumed to be fair.

At this stage an expansion of credit begins: more money is put into circulation, its purpose being to develop certain resources and so to increase at a later date the quantity of goods and services available for consumers. In practice, an expansion of credit will direct money to more than one branch of industry and will rapidly lead to some increase of consumable goods. In so far as it does this the result is merely an enlargement of the figures used in our illustration; no change takes place in the division of the product. We may therefore ignore the money that has this effect and attend to that which, though it immediately increases consumers' income, produces for the present no more goods for the consumers' market.

The new money can only be spent on goods

[1] A simple term to use in this sense has long been required, and Mr. Hawtrey has provided the one I have adopted. (See *The Art of Central Banking*, by R. G. Hawtrey, p. 89.)

already marketed. There is more money, but no more goods; therefore the price of goods rises. It will not rise at once; traders do not know that more money has been issued and may be had for the asking. Moreover, they are not all theoretical economists applying quantity theories to the regulation of their own businesses. A delay occurs until persistent pressure of demand depletes their stocks, whereupon in ways we have already described the upward trend of prices begins.

The difference between the old prices and the new is an addition to the profits of the traders. The national income has been redistributed in favour of the trading class. This has been achieved on the initiative of the traders themselves; no new bargain has been struck with society entitling them to a greater reward. By raising prices the traders have diverted to themselves the new money that should in justice remain spread among the community in the same proportion as the old. If the traders were fairly paid with £500 when the national income was £2,000, they should receive £550 [1] when the credit expansion raises total income to £2,200. Instead—apart from certain modifications to be mentioned later—they will receive £700.

During the stable period that preceded the ex-

[1] To award the traders £50 of the new £200 is not, of course, to admit that prices must rise even to this extent. The £50 is that portion of the new income which, being distributed as profit on the new output, will enable the traders to purchase their quarter of it. To show the working of this would lead to a paradox that could not be easily resolved within the conditions of our simple illustration.

pansion, incomes derived from selling goods at a higher price than that for which they were produced or bought did not appear essentially different from incomes based upon an estimate of the worth of labour or skill. A profit, too, might justly assess the worth of the labour and skill applied by traders to production and distribution.

Now, however, an important difference between the two modes of remuneration becomes evident. The implied bargain has been broken by the traders during the expansion of credit to the disadvantage of the rest. They have varied the division of the product in their own favour, and if it was fair before it is unfair now.

Whatever disparities in individual incomes society may be deemed to have assented to, this is one concerning which its opinion has not been asked. Moreover, society cannot be assumed to have assented to it by its general acquiescence in profit-taking as a mode of remuneration, for a name has been found for the exaction of undue profits, and wherever 'profiteering' is recognized it is condemned.

Among the traders themselves the increment so gained may not be divided equally, though in time it may tend to be. We must not suppose that the only trader who raises his price and reaps an extra profit is he who has goods ready for the final consumer. A ton of iron ore, though useless to the domestic consumer, is marketable when dug out of the earth, and its price will be raised to the steel smelter if his demand for it is pressing enough.

A billet of steel is marketable, and the car manufacturer who competes for it with other engineers may be asked to pay more than he did last month. The initial thrust, indeed, comes from the final consumer who wants more cars, or is expected to want more by dealers, but it is not necessarily the trader who delivers the finished car that benefits most, or even first. The important thing to note is that the trading class as a whole is the one that benefits.

Among the non-trading class the unemployed benefit too, in the sense that they now have wages where formerly they merely had doles; but they gain at the expense of the other consumers, whose income is proportionately reduced in purchasing power. It may also be said that the traders themselves pay more for what they buy as private consumers. So they do; they profiteer at their own expense; and if the trading class comprised the whole community the result would be no change. As it is, they profiteer at the expense of the non-traders as well, and the net result is an uncovenanted gain for the trading class alone.

The traders, it is true, are not left in unchallenged possession of the increment. Other classes seek to raise their own incomes to meet the rising cost of living. They cannot take the initiative, as the traders do; their incomes in fact mostly reach them via the trading class, and whether they can successfully demand more depends upon their bargaining power. Those who belong to powerful trade unions will sooner or later be partially successful, but the

income of the non-traders as a whole will never overtake that of the traders while the expansion of credit lasts. When it ceases, then indeed many of the non-trading class will rejoice in a period of comparative ease. Poor deceived creatures! Millions of them are about to be thrown out of work, for the situation contains just the factors that produce a trade depression.

What happens to the profits? A portion is spent in raising the traders' standard of living, but much of it is invested. During an expansion of credit especially, a large quantity of capital wealth is created above that required for normal replacements. Factories are extended, new ones built, new plant is laid down, and instruments of production generally are increased. This new capital is intended to be a permanent addition to the country's assets, and its financing is carried out on that basis.

Temporarily much of it is financed, directly or indirectly, by bank credit. Eventually shares are issued to the investing class, that is, to those whom we have called the traders, who pay for them out of their profits and thus acquire ownership rights in the new capital and a claim upon its future productivity. In many cases nowadays the profits of a business are directly applied to extending its own capital instead of being distributed as dividends among the shareholders. Whatever method is employed, the traders acquire industrial property at the community's expense.

the deflation of credit about to ensue will reduce the community's income, just as the expansion raised it, and traders competing among themselves for orders will lower prices to attract them. This is especially likely to take place when output is increased through the greater productive capacity created during the credit expansion, now presumed to have ceased. Working on a narrow margin of profit, or content even to recover their costs, traders would be surprised to be told that the main cause of the economic stress was profiteering by themselves, yet we have seen that to be the case. Past profiteering causes present poverty, to the profiteering class among the rest, though not necessarily to the same individual profiteers. Many of these will have feathered their nests and retired from the field, being gainers rather than losers by falling prices.

Manifestly profits are a cause of disequilibrium and injustice. The difference between a profit and all other modes of remuneration is revealed as fundamentally important. A profit is not, as in economic theory we are sometimes able to regard it, an item in the cost of production. A profit is the difference between that cost and the price, as of course every trader knows. This would not affect the position if price were a fixed quantity, but it is not; price is determined, other things being equal, by the quantity of money expended, and that proves to be a radical defect.

Profits as defined, therefore, can form no part

of a just and stable economic order. The remuneration of those we have called the traders must be determined before price is fixed. The price of a commodity will include this remuneration, along with all other charges, and there it will stop. It may be large or small, but it will not be increased merely because roads or bridges or factories or commodities are being financed with new money which would ensure a higher price being paid by consumers if it were demanded. It must not be demanded; at least it must not be demanded by private persons for their own enrichment.

We have now reached exactly what we were seeking: the principle upon which prices must be controlled. The basis of the just price is the cost of production; in fact the just price *is* the cost of production. Price and cost must be equal; they are two aspects of the same thing. The price of a commodity is the sum of all the expenditure incurred in producing it, including of course capital depreciation and all those items covered by the term 'overhead charges'; including also the remuneration of traders; but not including a fortuitous profit gained because there happens to be more money in circulation than the production of existing saleable commodities has itself distributed. The remuneration of the traders cannot take the form of a profit.

Simple though this looks, the difference between the principle involved and the one on which current practice is based is so important that we must

inspect it a little more closely. Perhaps we shall be helped if we try to see it through the eyes of a trader, especially as we have yet to ascertain on what principle the remuneration of the trader, since it cannot be a profit, must be based.

$P = C$ = Normal Money

$P = C + f$ = Excess of Money

CHAPTER VIII

A TALK WITH A TRADER

Tell the average trader that price must equal cost of production and his comment will be: 'Then the manufacturer and distributor are to get nothing!' We might reply: 'Oh, yes, they will. Some of them may even get more than they have been getting lately, if they are as badly hit as they proclaim. Society is now going to look into these things for itself, but nobody proposes that the manufacturer and trader should have no incomes'.

'There 'll be nothing to pay them with if you sell goods at cost,' the trader may object.

'Would you say there 'd be nothing to pay wages and salaries with if you sold goods at cost price?' we ask.

'No. Wages and salaries *are* costs. Obviously a man could get back all his costs, including wages and salaries, if he sold at cost price, so long as he wanted no profit for himself.'

'And if he could get back wages and salaries by charging them into price, as he does now, he could get back his own remuneration if the price were a little more.'

'Certainly. The "little more" would be his profit.'

at the lowest possible cost. Surely you won't deny that—whether the factory is run privately or by the Government.'

'No, I won't sneer at efficiency, and I 'll accept your definition of it. To provide the most wealth with the least effort may be taken as the object even of socialized industries. But I should hardly call it our most difficult task to-day. We find it much harder to get goods distributed to consumers than to produce them. In fact, many people consider it the problem of this age. And if we should find that your method of providing "incentives" turns out to be one of the main generators of this problem, then it is clearly doing more harm than good. Let us look more closely at this question of incentives.'

'No; let us look first at your own method of remunerating the producer. I haven't grasped it yet. You spoke of a salary, but you didn't quite turn down the notion of a commission, which would surely be a sort of profit. What difference would it make in practice?'

'It would prevent the manufacturer, or anybody else who handles goods on the way to the consumer, from raising prices when there happens to be more money about, as we hope there may be soon.'

'Little chance anybody has of raising prices lately! But suppose we do get another boom. Won't costs go up? And if a manufacturer's costs go up, his prices must go up too.'

primary producer is the only person doing well while the boom lasts. By the way, we 're getting off our track. This selling at a loss that you mentioned belongs to the system of profit-making which we are going to supersede. These losses will go the same way as profits. They won't occur.'

'I 'm sure we shall all be glad of that. Let me see if I 've now grasped your idea of price control. The price of a commodity is to be the cost of production plus something for the trader which——'

'No, no! Plus nothing! The price of a commodity is to be its cost of production. The remuneration of a trader must be one of the items in the cost.'

'Does it make any difference? Look here; suppose I 'm a boot manufacturer. (I was never in boots, so my figures will all be hypothetical.) And suppose I can make a pair of boots for nineteen shillings.'

'What does the nineteen shillings cover?'

'Everything except profit. Labour, material, depreciation, interest on loans—all charges of every kind except something for myself. Now suppose I sell the boots for twenty shillings, taking a shilling profit on every pair. Would you call that shilling my "remuneration", and consider it part of the cost of production?'

'Tell me, how did you arrive at that shilling? Not merely in your illustration: any figures would do for that, of course. But in your own business did you say to yourself: "My services as organizer

and capitalist of this establishment are worth a shilling on every pair of boots turned out. My costs are nineteen shillings, therefore I must charge twenty shillings for the boots"?'

'No, I certainly never put it to myself like that.'

'Or did you say: "My services are worth £3,000 a year. To get that with my present output I must price each pair of boots at a shilling above gross cost"?'

'No; one doesn't reach a price in that way either, so far as I've ever heard.'

'Well, will you tell me how you did fix a price?'

'If you don't mind my mentioning it, I seem to remember asking you a question which I don't think you've answered yet.'

'You mean about your shilling? Whether I should let you have it and call it a cost of production? Forgive my dilatoriness; but we're really on the way to an answer. About this price-fixing: would it be broadly true to say that you always charged as much as you could get?'

'My dear fellow!'

'Don't be offended. Let me put it less crudely. The price you asked for your products was the highest that you estimated you could obtain without causing demand to fall below the capacity of your plant.'

'Yes, that doesn't sound far wrong. Only a good deal of my time seems to have been spent in calculating not how much I could get but how much I could knock off without wiping out my profit.'

'And how much you could cut down costs in order to maintain your profits while prices fell. Naturally you would remember those things most clearly because they imposed effort upon you. To raise prices when demand is plentiful is easy enough. But you must have had both experiences during your long career. No doubt you remember one or two booms.'

'True. There have been many ups and downs, but some periods stand out. I can remember three pretty important booms, including the war one.'

'I dare say I could name the dates, though it doesn't matter. They were periods of general trade activity when money was plentiful and prices were rising. Did you find during those booms associated with a rising price level that profits were rising too?'

'Certainly.'

'Didn't the price per unit of output—per pair of boots, we'll say, sticking to your illustration—rise more than the cost? What I want you to admit, if it is true, is that your profits rose during those booms not merely because you sold more boots but because the profit on each pair was greater.'

'Very often that would be so.'

'Your shilling a pair had grown to fifteen pence or perhaps more a pair.'

'Yes, there might be all that difference between good times and bad in the margin of profit.'

'Well, now, under our system of controlled prices those fluctuations in profits could not take place. If that shilling of yours a pair was admitted by all

parties to be a fair method and rate of remuneration for your services, that is what you would get; no more and no less. The answer to your earlier question is: Yes, we *should* call that shilling your remuneration, and include it in the cost of producing whatever your factory did produce. And having fixed that remuneration, the price-fixing authority would be in a position to ascertain *all* the costs of production incurred in your factory, and similarly all the costs of production incurred by the industry to which it belonged, and to fix the price of output so that the cost was exactly covered. The amount of money distributed in the course of producing the output of any particular branch of industry would be exactly recovered when the output was sold. And we should know how much it was.'

'I think I've got it. The manufacturer's profit—I beg your pardon: his remuneration—must be fixed before the price is fixed, and mustn't be altered.'

'That's it. At any rate it may only be altered as anybody else's remuneration may, for reasons of justice or expediency. If it is altered, price will be altered correspondingly. But the alteration will be planned; it will not be permitted simply because more money is going into circulation. If we imagine a sort of Industrial Chancellor of the Exchequer preparing a budget for each industry, all the budgets will balance, none showing an undesigned surplus obtained by permitting prices to rise above costs.'

'And if I want to make a bigger income, must I

ask for more than a shilling on each pair of boots, or must I produce and sell more pairs?'

'To be candid, I hardly think you 'll be paid so much per pair of boots. As an active producer you 'll receive a salary—which of course will amount to the same thing so far as costing is concerned. Each pair of boots will naturally bear a certain proportion of your salary in its cost. As production grows more efficient, costs and prices will fall and your salary will purchase more. But if you want a higher salary you must apply for a job that carries one. For I 've no doubt there 'll be different scales of pay for many years yet. Possibly your salary may rise with the increased efficiency of the unit you control. You don't want me to lay down rules on every detail.'

'You 've laid down some pretty big ones. I 'm still full of questions. I 'm to get a salary so long
bcs I 'm in active control—as a matter of fact I do
mor director's fees. But what do I get for the
if it ey I 've invested? How would you get money
booms idustrial enterprises at all if you offer no
because A little while ago you mentioned the word
'Very ve". Don't you think the abolition of
'Your say have disastrous effects on efficiency
or perhaps rise?'
'Yes, thert would have the most beneficial effects
good times a
'Well, now ish me.'
those fluctuat ile ago you defined industrial efficiency.
If that shilling many goods as possible at the lowest

possible cost," I think you called it. You would agree, no doubt, that you must also distribute them at the least possible cost.'

'Certainly. Distribution is a highly important part of most trades nowadays.'

'And a very expensive part, it seems to me. I expect you have heard of commodities that are said to cost two or three times more to sell than to make? Much of the efficiency so much prized by traders consists in persuading people to buy things they could do without, or to buy one variety rather than another no different.'

'We do spend an enormous amount of money in that way. In recent years, since I've been connected with rather big business, I've often thought what a lot of expenditure of that kind could be cut out if a few big men in each trade got together.'

'If you did, and did nothing else to absorb the shock, the result would be devastating. Think how many people earn their living out of it. Look, here's a newspaper cutting I've kept. "The range salesman must recognize that his task is that of diverting money from the purchase of anything or everything to the purchase of an electric range." That was from an American paper, I think. But in this country also there must be many thousands of people—canvassers, advertisement writers, artists, salesmen—spending all their working hours trying to divert money from the purchase of something to the purchase of something else. All that effort is

a loss to the community of so much real production or so much leisure.'

'I believe the advertisement people have some sort of answer to that. Something to do with creating greater demand, and so leading to larger output and reduced costs.'

'Diverting demand from Brown's electric ranges or fountain pens to Jones's doesn't make demand any greater.'

'As a matter of fact I 'm not much inclined, as a producer, to defend all that unproductive expenditure. The efficiency of which I was speaking was productive efficiency. Is it old-fashioned to suppose that the incentive to that will go, or at any rate be much reduced, if nobody is allowed to make a profit?'

'Let us learn from your own experience. Most of your income has always been derived from profits, I believe. Were you concerned mainly with the small one-man type of business or have you always operated on a large scale?'

'I started in a one-man business that I took over from my father. I made it into a private company. It grew, and later we merged into a combine. I had a seat on the board. Of course I get profits from other concerns as well—when they pay any, which isn't too often just now. I began to spread my interests years ago, in a way that would have shocked my father, who believed in putting all he could spare back into his own business.'

'Possibly because it was the only business he

professed to understand, or whose efficiency he could influence. Perhaps some of your own financial interests lie in concerns that you wouldn't claim to understand technically.'

'That is true.'

'And similarly many of the shares in the combine you direct are held by people who have never been inside its works except to attend shareholders' meetings, and certainly have no voice in its management. In other words, the prospect of dividends provides no incentive to these people to do anything at all, so far as increasing the efficiency of the company is concerned. They can't affect its efficiency one way or the other.'

'The incentive that moved them may have come earlier—an incentive to enterprise. But for the expectation of profit they might not have put their money into the concern.'

'What would they have done with it?'

'Put it into some other concern. True, if no businesses at all are allowed to pay profits, those people are baulked. They must accept a fixed return on their money.'

'Assuming that under our plan we continue to finance industry in that way at all, which I think very improbable. But at all events we shall perhaps agree that so far as the shareholders we are discussing are concerned, the payment to them of fluctuating profits does nothing to promote the efficiency of an industrial unit, and no harm would be done on that score if the payments were

exchanged for fixed—and perhaps diminishing—annuities of some sort. And doesn't this cover an enormous number of people who receive profits? Those who are at the same time shareholders and sufficiently involved in the management of a business to affect its efficiency must be a small minority.'

'Nevertheless the efficiency of industry as a whole may depend upon this minority, though there may be only one or two in control of each business. To abolish profit is to take away the motive which induces these key men to strive for efficiency, and the country as a whole may suffer.'

'How alarming you make it sound! Still, if we have to offer special rewards to bring the best out of these key men we can do so. It does not follow that we must distribute proportionate rewards to the many outside who contribute nothing but the use of their money. Let us think, then, of the insiders only. Has it been your experience that men who have money in a business, and also a share in its management, are always indispensable to its efficient conduct? You smile. And indeed most people can cite cases where the prosperity of a business is by no means furthered by the presence of certain men who share in its profits. Now you, on the other hand, I have pleasure in assuming, undoubtedly promoted the efficiency of the concerns that enjoyed your control. Did you always find yourself fighting a lone battle against the opposition or the inertia or the unintelligence of

your staff, who, because they had no money in the business, displayed no care for its efficiency?'

'Oh dear, no. I've always had many helpful fellows on my staff. A man can't run the show himself nowadays. It's too big. And too technical. When I first took over from my father I reckoned to know the trade from beginning to end. Later on my technical fellows went miles ahead. Always springing surprises on me for my own benefit. And in other departments as well I had men capable of showing me that I didn't know it all. Mind you, I paid them good salaries.'

'Salaries? You didn't say, "We'll put the price of boots up a penny a pair, and you fellows shall have the proceeds of that"?'

'I did not. Nor did I adopt any other of those payment-by-results, share-in-the-bunce ideas, so far as my inside salaried staff were concerned. Some people think those methods pay. I find I did very well by offering men a good salary and assuming they'd do their best for the firm all the time. This goes a bit against what I've been saying, I know; but after all I was there, and alert, and the men knew it. I see Sir Arthur Duckham has been writing about inefficiency in Government employment. The reason for it, he says, is that it is so difficult to sack anyone.'

'Sacking people doesn't solve any problem; it simply transfers the problem from the firm that sacks them to the one that takes them on, or to society if nobody does. At the best it is the way in

which a chaotic and not very efficient industrial system tries to fit men into the jobs they can best do; but it only performs half that task with any vigour, pushing them out of jobs they can't do, but giving them little chance of finding others. A properly co-ordinated industrial system will avoid that waste of human material. As for the alleged inefficiency of Government servants, we must all speak from our own limited experience, and my experience is that an enormous amount of inefficiency is to be found all over the place, in commercial concerns as much as anywhere else. Both as consumers and producers, most people can cite numerous examples of inefficiency in business establishments that nevertheless manage to succeed—no doubt because their competitors are similarly affected. I should be surprised if those assistants of yours were as efficient and conscientious as you admit they were simply because they knew you could sack them.'

'I hardly meant to put their loyalty as low as that. But at any rate they knew that I was personally concerned with the prosperity of the business, and therefore with what they were doing towards it. Would I have been so much interested in their work if I weren't profiting by every improvement made? Would I have been so keen on the good of the factory if I 'd simply been paid a salary by the Government, or whatever body it is that would pay me?'

'Wouldn't you?'

'Well, well! . . . Now you put it to me, frankly

I don't know. I like to think that I should. But I believe I could name a few men in similar positions who certainly wouldn't.'

'Perhaps they oughtn't to be in those positions. And perhaps they could easily be replaced by people who work conscientiously without a special private bonus for every piece of good work done. On your own evidence such people are not scarce. You found them among your salaried staff. You may be one of them too. There may be many among the controllers of industry whose reward at present mainly takes the form of profits. Their worth to society would not be reduced by changing the mode of remunerating them. Moreover, the success or failure of their work would not be hidden, either from themselves or others. The achievements of their units would be compared with those of similar units, at home and abroad. Would they not take pride in success? Surely pride and shame are emotions that move us powerfully to action. They are incentives! The spirit of competition is said to be natural to mankind; we used to be told so by people who merely sought to prove that men will always try to satisfy their greed at each other's expense and ought not to be prevented. Remove competition from that low plane and it will operate on another, if it is as natural as all that, and perhaps with better results. For the competition of men and nations in pursuit of profits has brought us to a state which the most ardent individualist can only deplore. And this profit-seeking obsession

society from which the ideology of profits had vanished would think it reasonable to make special payments to certain individuals simply because their grandparents happened to have occupied a rather dubious position in a superseded social regime.'

'What awful fellows we grandparents are going to seem to our grandchildren! But returning from their time to ours, haven't you, in your gradual elimination of most profit-makers from the category of useful persons, forgotten one very large group—the shopkeepers? Or must we all buy goods from a Government store?'

'Personally, I like shops, including small shops. I dare say most people do. Shops needn't bother us, for a shopkeeper's "profit" is not a profit in the sense that matters. It isn't some indefinite sum added to cost and varying with the quantity of money available. In times of uncertainty and crisis it may be, but normally and in most cases it is merely the difference between cost and a predetermined price. This will certainly be so when prices are controlled. Cost, by the way, means in the case of a retailer, wholesale price. His own expenses, as well as his remuneration, will come out of the difference between the two prices.'

'The shopkeeper's remuneration, in fact, is a commission on sales.'

'Yes. You might almost call it a commission on output; and in his case it is a reasonably fair way of remunerating him. To sell a hundred packets

of tea across the counter means twice as much work, roughly speaking, as selling fifty. But reverting to manufacture, did you ever have difficulty in ascertaining your costs? Some people think that costing is a great and complicated mystery which is bound to make our proposals difficult to apply. True, they are usually people not closely connected with industry.'

'People that *are* closely connected with industry are often inclined to make a complicated business of it too. Every manufacturer knows what his costs are, and can allocate them pretty accurately in a general way. But they want to do more than that nowadays. A nephew of mine used to bring home great volumes on costing. He joined a motor engineers'. There are hundreds of parts in a motor car, and he wasn't content to know how much a car cost to make, and how much of it went on labour, how much on plant maintenance, how much on raw material, and so on. He wanted to know exactly how much to three decimal places every split pin cost. Whether he found out or not I don't know. Quite likely he did; but he didn't find out how much the car cost that way. They knew that before he joined them. I once knew a bright young lad who came to help his father's business and started by costing every single part of the stationary engines they manufactured. He added up the items and told his father the engines cost fifty-seven pounds twelve shillings each. "That 's funny," said the old man. "I 've been selling those engines

for forty-eight pounds. I wonder how I managed to buy our house and put away fifteen thousand?" Perhaps there 's more in this detailed costing than I allow, but I doubt if there 's as much as my young nephew thought.'

'At all events, you had no difficulty in ascertaining the total cost of your output, and therefore the proportionate cost of each unit.'

'There 's no difficulty in finding total costs, or the cost of each unit where the units are all of the same sort, like boots or bicycles. Even if you produce a varied output you can generally allocate costs pretty accurately. It is a matter of getting your overheads spread out fairly. But in some cases it isn't so simple. Where a single plant produces, say, coke, gas, aniline dyes, and two or three saleable chemicals all from the same raw material and by the same series of processes, then one is quite unable to say how much of the total cost ought to be charged against any one of the products. Still, even then you know your total cost just as you do in any other sort of business. And having got that, all you have to do is to make sure that you 're using the most efficient methods and everybody is doing fair work for the money he gets. If these two conditions are fulfilled there can't be much wrong with your costs.'

'And you would expect to be able to see that they were fulfilled in any productive unit of reasonable size placed under your control. It wouldn't make any difference to that if the unit happened

to be associated for financial and marketing purposes with other units in a sort of rationalization scheme?'

'So far as I can see it need make no difference.'

'Nor would it, I suppose, if the rationalization were carried out by some sort of public corporation?'

'No, I suppose not, so long as I was not interfered with.'

'If the interference took the form of presenting you with information about improvements and experiments that had been carried out in other units which formerly were your competitors, you would be helped rather than hindered?'

'I should think so! It sounds Utopian—but not quite so impracticable as I should once have thought it. Anyhow the poor old world has evidently got to change its ways. That's becoming clear to the most conservative. But don't be too hard on us poor capitalists.'

'We won't be nearly so hard on you as the world is going to be if we let you run the show alone much longer.'

CHAPTER IX

INDUSTRIAL GROUPING

The costs of production, then, will be the remuneration of those engaged in it and of those who, while not actively engaged, have claims which society deems it just or expedient to recognize. If prices are equal to costs as thus calculated, the remuneration paid for different services and rights represents what it is intended to represent when distributed, not afterwards being varied in amount or purchasing power to the advantage of any class. Changes in price will not occur through certain classes receiving more and others less than they bargained for. That is one advantage.

The plan will tend towards equality of incomes, and thus prevent whatever disequilibrium may be caused by the piling up of fortunes in the hands of a few who may spend or hoard or export them at their own will. That is a second advantage.

The third, and at present the most important of all, is that the central bank may freely issue all the money that trade and industry require without fearing the consequences of an inflated price level.

Prices need never rise from monetary causes. They need never fall either, and if a stable price

of leisure among its citizens as well as the individuals whose burden is lightened. This benefit our productive capacity is already capable of bestowing. Quite apart from any technical advances, the mere restoration to activity of two or three million men and machines, combined with the reorganization which financial ease and an assured market will encourage, can be relied upon to expand output sufficiently to provide more leisure for the hardest workers without reducing wages or raising prices. This may take place in the course of months rather than years.

The time will come, however, when the benefits of industrial improvements and development should be shared among society as a whole. For many years our capacity to produce seems bound to increase more than proportionately to the growth of population. Few will argue that the increment of output should be enjoyed only by those actively engaged upon productive work. The improvements effected may indeed be due largely to their initiative, and it may be thought just that they should receive, as producers, a special share of the benefit in addition to that which they will necessarily have as consumers if the rest of the advantage is distributed among the community by means of lower prices. But that they are not entitled to the whole of it seems equally plain. The producers make use of national resources and an inherited body of knowledge and technique which also must be regarded as a national possession. These assets are not the private property

of industrialists but are entrusted to them to use for the public good.

If all the community consisted entirely of producers, acquiring their incomes as such, the problem would be simply that of spreading the increment equitably among those engaged in the different branches of industry. But not everybody is engaged in industrial production, and the proportion will probably decrease. Some will have retired from industry and be living on pensions honourably earned, or on savings made without hardship. Others will be teachers, doctors, painters, musicians, and similar practitioners whose vocations permit of technical advances indeed, but not of a kind that enables a larger 'output' to be secured for a given effort. Followers of these vocations, if their standard of living is to rise correspondingly with that of the industrial producers, must constantly raise their fees if the producers seek to reserve to themselves all the benefits of improved output by increasing their own incomes or leisure; for this assumes the maintenance of prices. And those who do not even charge fees but live in retirement will have no means of raising their standard of living unless their pensions are constantly increased.

These adjustments could of course be made; but to lower prices seems a more convenient, logical, and automatically just method of distributing the increment of wealth among the community. Therefore, after a period during which wages and salaries are levelled up and working hours reduced, the

remuneration of producers will remain stabilized. Improvements that lead to increased output per man will reduce the cost per unit of goods, and its price to the consumer will be lowered. This does not preclude the payment of monetary rewards to those responsible for the improvements, if incentives of this kind are thought necessary. Such payments would delay or diminish the reduction in cost and consequently the fall in price. The tendency throughout society, however, would be for incomes to remain stationary in terms of money but to increase in purchasing power as prices fell.[1]

These arrangements, however, are hardly possible while industry is carried on by a vast number of competing, unco-ordinated units. If, for example, the costs of a productive plant are assessed and the prices of its output fixed separately from those of similar plants, we might have the same commodity selling at two or more different prices.

For this and for still stronger reasons the process of rationalization which went on apace for some years through private stimulus should continue and be expedited under public control. Industrial units producing similar commodities should be regarded as one organization. This does not imply the concentration of production in a few enormous factories, nor an undesirable amount of centralized control. Doubtless many ill-equipped and unsuitable units

[1] These questions are discussed at greater length in the present author's *Money and Prices*, chaps. xi and xii.